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TALKING POINTS ON EAST EUROPEAN FINANCIAL SITUATION

The revival in Western bank lending to Eastern Europe last year obscures the continuing financial weakness of these economies.

--The increase in loans reflected fewer lending opportunities elsewhere more than improved creditworthiness in Eastern Europe.

--The improvements in hard currency trade performance in 1982-84 were obtained primarily by suppressing imports rather than by expanding exports. The limitations on imports have hurt these economies, forcing declines in investment and delaying badly needed industrial modernization.

--The region was unable to sustain its economic recovery last year as growth slowed and the region's hard currency trade surplus fell to $3.3 billion from $6.3 billion in 1984.

The ability of the East European countries to improve their financial position faces numerous constraints.

--The regimes do not seem prepared to make the systemic changes needed to improve their competitiveness in world markets.

--Soviet demands for more and better quality goods from these countries will siphon resources away from export promotion.

--The newly industrializing countries (NICs) will pose an increasingly severe competitive threat. The East European countries will be pressed hard even to maintain their market shares.

--Growing Soviet hard currency problems, which might prompt greater Soviet borrowing in the West, could crowd the East European countries out of credit markets.

--Moscow's hard currency problems potentially could result in some decrease in Soviet oil deliveries to East Europe, which could force these countries to spend hard currency to purchase energy.

The outlook for these countries varies.

--Poland remains so financially strapped that it cannot even make enough payments to keep its debt from growing. A continuing series of reschedulings seems likely.

--Romania has managed to reduce its debt, but at a crushing cost to its populace and economy by imposing draconian restrictions on imports. Even these measures have not totally eliminated financial problems as there are indications Romania has encountered at least temporary liquidity problems.

--Hungary remains a heavy borrower because of persistent weak export performance. Because of the rapid runup of debt last year, bankers are beginning to show some resistance to new credit requests from Budapest.

--The GDR's economic performance has been the strongest in the region. Bankers remain willing to extend credits at favorable rates and terms.

--While Bulgaria and Czechoslovakia may repeat their small borrowings of last year, both countries are likely to maintain their conservative financial policies and close economic orientation to the USSR.

Continuing financial problems are likely to hamper Eastern Europe's ability to expand trade with the West. Eastern Europe will be pressed hard to finance imports from the West to modernize their industries and to make them competitive in world markets.

--The regimes will be more conservative in their borrowing because of their bad experiences in the 1970s. Creditors will be more cautious in lending to these countries and will try to limit loans to the more creditworthy.

--For the most part, the regimes will probably try to use borrowings to finance imports of Western machinery and equipment.

--Occasional downturns in agriculture and industry, however, may lead to temporary surges in imports to minimize economic disruptions. Borrowing will be used to finance such increases in imports and to compensate for unexpected shortfalls in exports.

Talking Points
10 March 1986

Soviet Balance-of-Payments Outlook

The Soviet Union's hard currency position is the worst it has been in over a decade due to falling oil production and declining world energy prices

--Exports fell about one-fifth to $25 billion in 1985--largely due to a 300,000 b/d drop in oil sales--while imports declined to a little over $24 billion.

Most of the hard currency shortfall was offset with increased borrowing. According to Western financial statistics, Soviet debt to Western banks climbed $5 billion through the first 9 months of last year, with much of the borrowing short term.

--In addition, the Soviets boosted gold sales and sought deferred payments or credits from suppliers.

This year may prove to be a pivotal year for Soviet trade policy with the West as hard currency earnings plummet further.

--The Soviet's credit rating remains high--they could borrow more if they wish--but at the moment they do not appear willing to relax their conservative borrowing policy and expand their debt.
--Additional gold sales are likely without disrupting the market.
--The USSR may also attempt to expand non-energy exports and step up pressures on suppliers to accept countertrade deals.

Imports cuts this year are likely to be much sharper than those in 1985, regardless of the strategy adopted. The Soviets may have some leeway to reduce agricultural imports, but will have to make painful choices regarding reduced purchases of industrial inputs, and machinery and equipment.

The Soviet Union's hard currency position is likely to remain tight the rest of the decade, keeping import levels depressed and posing a serious threat to Gorbachev's modernization program.

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